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Agriculture by Susan Cohen

The Fed threat to the farmer

Auto has collapsed, housing has collapsed and other sectors are hit hard by Paul Volcker's measures. Now it's the farm economy's turn.

Farm bankers and agricultural economists contacted in the immediate aftermath of the Federal Reserve's announcement of the credit control measures in the new Carter administration "anti-inflation" plan bit their tongues and insisted that they could not fathom what the implications of the restrictive measures might be for the regional banking system and the agricultural sector. The Fed moves last week could very well precipitate a catastrophe in the farmbelt.

Take the Fed's Tenth District, in the midst of the Farm Belt, for instance. The Kansas City Fed's mid-February agricultural credit survey reported that as of January 1, 1980 rural banks had "less liquidity than expected," adding that district bankers looked forward to the establishment of a paid diversion program to bring some needed funds into the area during the first quarter. They got no diversion program and a grain embargo instead. The latter virtually put a halt to anticipated cash receipts, as marketings slowed or stopped. Inventories piled up at country elevators and on farms, where despite the price recovery in the national and futures markets, prices have remained weighted down by local supplies. This has pushed up loan demand throughout especially in the Minneapolis district where the grain embargo was preceeded by transport strikes that shut down the ports for months before the winter cold froze them shut.

Farm loan interest rates picked up at least 4 points over 1979 alone. For a typical farm operation that needs $200,000 in operating loans per season, that means a nearly $10,000 increase in operating costs for interest charges alone in a single season.

Now, just since January 1980, the interest rate pack leader, the prime rate, has been pushed up another five points. The general inflation rate set by the spiraling cost of credit will push up production costs, cutting income and making additional credit a necessity—at a time when banks are forced to "restrain" it— directly because they don't have it, or by pricing it out of reach.

Historically dependent on the local deposits for loan funds, regional banks have been chronically strapped for cash since 1976, as the farm sector experienced repeated financial difficulties, and have become increasingly dependent on money-center funds. Once net sellers of federal funds as a group, the percentage of net buyers of federal funds among regional banks had risen from 10 to 18 percent between mid-1978 and March 1979. In 1978 the rural banks introduced a new six-month money market Certificate of Deposit—which within a year after its first offering made up 5.7 percent of total resources for the agricultural banks, and has since nearly doubled.

Money-center funds act as conveyor belts for the interest rate hikes into the regional banking system, which until now has run on a track several notches below money center rates structures. Forced to pay the going rate for these funds, the banks have no choice but to pass along the charges to their borrowers.

Furthermore, now it is precisely those resources—bank funds above and beyond deposits, or the so-called managed liabilities—which are one of the prime targets of Mr. Volcker. The new Fed measures raise the reserve requirements on these funds from 8 to 10 percent, and lower the base on which these requirements are imposed by at least 7 percent. Also, for the first time, nonmember banks are required to keep a 10 percent reserve against managed liabilities on deposit at the Fed.

The immediate effect of the measures will certainly be to put even more pressure on the Farm Credit System— the cooperative system of Production Credit Associations, Federal Land Banks and Banks for Cooperatives that, as a whole, have direct access to money markets, raising funds there through bond sales. The System will have a relatively surer access to loan funds, albeit at the going rate. Already for the past six months, PCA lending has been running at 25 percent greater than year-earlier levels. As of January total loans outstanding at the PCAs were up 22 from a year earlier. Qualified observers worry that controls may be applied to FCS, crimping its ability to raise funds.

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